

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER



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ARIZONA CORPORATION COMMISSION

DATE: August 28, 2000

DOCKET NO.: W-02113A-00-0233

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Karen Nally. The recommendation has been filed in the form of an Opinion and Order on:

MCO PROPERTIES, INC.
(TRANSFER STOCK)

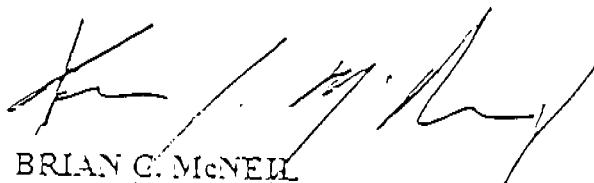
Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

SEPTEMBER 6, 2000

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

SEPTEMBER 12, 2000 and SEPTEMBER 13, 2000

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250.


BRIAN C. McNEEL
EXECUTIVE SECRETARY

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 CARL J. KUNASEK
CHAIRMAN
3 JIM IRVIN
COMMISSIONER
4 WILLIAM A. MUNDELL
COMMISSIONER
5

6 IN THE MATTER OF THE REORGANIZATION
OF MCO PROPERTIES, INC. BY THE
7 DIVESTITURE AND TRANSFER OF THE STOCK
OF CHAPARRAL CITY WATER COMPANY TO
AMERICAN STATES WATER COMPANY.

DOCKET NO. W-02113A-00-0233

OPINION AND ORDER

8 DATES OF HEARING: August 10, 2000; Public Comment on August 15, 2000
9 PLACE OF HEARING: Phoenix, Arizona
10 ADMINISTRATIVE LAW JUDGE: Karen E. Nally
11
12 APPEARANCES: Joan S. Burke, OSBORN MALEDON, P.A. on behalf of
13 MCO Properties, Inc.;
14 Thomas L. Mumaw, SNELL & WILMER, on behalf of
15 American States Water Company;
16 Richard L. Sallquist, SALLQUIST & DRUMMOND
17 P.C., on behalf of Chaparral City Water Company;
18 Teena Wolfe, Staff Attorney, Legal Division, on behalf
of the Utilities Division of the Arizona Corporation
Commission.
19

20 **BY THE COMMISSION:**

21 On April 18, 2000, MCO Properties, Inc. ("MCO") together with Chaparral City Water
22 Company ("Chaparral") filed with the Arizona Corporation Commission ("Commission") a Notice of
Reorganization and/or Request for Waiver ("Notice").
23

24 On May 26, 2000, Staff of the Arizona Corporation Commission ("Staff") filed a Request for
Procedural Order ("Request") requesting a hearing be held no sooner than sixty days from May 26,
25 2000 pursuant to A.A.C. R14-2-803.B and recommending MCO and Chaparral's request for a waiver
26 of A.A.C. R14-2-803 be denied.
27

28 On June 7, 2000, American States Water Company ("American States"), MCO, and Chaparral

1 filed a Joint Response stating that a hearing is not required and should not be held in the matter.

2 Our June 14, 2000 Procedural Order set the matter for hearing on August 15, 2000. The
3 parties then contacted the Hearing Division and requested a new hearing date due to a conflict. As
4 notice was already published, our June 23, 2000 Procedural Order rescheduled the hearing date to
5 August 10, 2000 with August 15, 2000 remaining as public comment. The hearing took place on
6 August 10, 2000 as scheduled and public comment was held on August 15, 2000. No member of the
7 public attended the public comment session. Additionally, MCO and Chaparral filed a Notice of
8 Filing Affidavit of Publication on July 10, 2000 with notice published on June 21, 2000.

9 On May 22, 2000, Mr. William E. Farrell, the Town Attorney for the Town of Fountain Hills
10 ("Fountain Hills"), sent a letter to the Commission stating that the Town Council authorized him to
11 indicate that Fountain Hills will be supporting the acquisition by American States and would
12 respectfully request that, if all other aspects of the Commission Staff's analysis of the particular
13 docket are consistent with the Commission's policies, the Commission grant this action. According
14 to MCO and Chaparral, the City of Scottsdale does not oppose the proposed change in stock
15 ownership.

16 DISCUSSION

17 MCO with its wholly-owned subsidiary, Chaparral, an Arizona public service corporation,
18 filed an application to divest and transfer Chaparral's issued and outstanding shares of common stock
19 to American States. Chaparral has a Certificate of Convenience and Necessity ("CC&N") to provide
20 both potable water and irrigation service to approximately 10,000 customers in Fountain Hills and
21 Scottsdale, Arizona. On March 10, 2000, American States entered into a contract with MCO to
22 purchase all of the common stock of MCO. After the closure of the purchase, Chaparral will be the
23 same legal entity as before, but it will now be a subsidiary of American States rather than MCO.
24 According to the application, Chaparral's CC&N and other property will not be transferred.

25 The application stated that pursuant to A.A.C. R14-2-803 ("Rule 803"), the Commission may
26 either approve the reorganization, permit it to become effective by taking no action within the 120
27 day notice period or waive compliance with Rule 803.

28 American States is a holding company with two principal subsidiaries, Southern California

1 Water Company ("Southern California"), which provides regulated utility services and American
2 States Utility Services Inc., which provides unregulated utility related services. Through its
3 subsidiaries, it provides water service to approximately one million persons throughout California.
4 MCO is not in the business of owning and operating public utilities and has chosen to divest itself of
5 Chaparral.

6 American States will initially finance the purchase with short-term loans of credit through
7 financial institutions with which American States has had on-going business relationships. Such lines
8 of credit are normally repaid through the issuance of long-term debt or common equity.

9 American States does not anticipate an increase in Chaparral's cost of service or cost of
10 capital as a result of the acquisition and that a rate increase application is not necessary at this time.
11 American States expects to operate Chaparral for a significant period of time before considering any
12 adjustments to rates.

13 Staff requested a hearing in this matter due to Chaparral's large customer base and due to
14 issues relating to pending lawsuits against American States' wholly-owned subsidiary, Southern
15 California, and issues relating to Chaparral's Central Arizona Project ("CAP") allocation.

16 In its testimony, Staff stated that under the terms of the Stock Purchase Agreement between
17 American States and MCO, the cash purchase price of \$31.2 million would be reduced by certain
18 debt obligations of Chaparral. American States will pay MCO approximately \$19.5 million in cash
19 for all Chaparral's common stock shares at the time of closing.

20 Staff reiterated that American States' testimony notes that a number of federal, state, county,
21 and local agencies including the U.S. Department of the Interior ("DOI"), the U.S. Environmental
22 Protection Agency ("EPA"), the Arizona Department of Water Resources ("ADWR"), the Central
23 Arizona Water Conservation District ("CAWCD"), the Arizona Department of Environmental
24 Quality ("ADEQ"), the Maricopa County Department of Environmental Services ("MCDES") and
25 the Fountain Hills Sanitary District have been contacted about the proposed reorganization and none
26 have questioned or opposed it.

27 American States has reviewed Chaparral's capital budget through 2002 and believes that the
28 existing plans are both prudent and reasonable. American States stated that it intends to follow the

1 existing Chaparral budget and will make amendments based on changing circumstances that involve
2 water quality issues, regulatory matters, environmental concerns or the expectations of the Fountain
3 Hills community.

4 Staff expressed concerns regarding pending lawsuits against Southern California and other
5 regulated water providers alleging they had delivered contaminated water to their customers. Other
6 defendants named in the lawsuits included a number of non-regulated water providers and industrial
7 entities. Staff's primary area of concern was public safety as the lawsuits allege that Southern
8 California had delivered contaminated water to its customers. Staff's second area of concern was
9 whether damages awarded to plaintiffs could expose Chaparral's customers to a situation that might
10 result in increased rates for them.

11 The California Court of Appeals concluded that the California Public Utilities Commission
12 ("California PUC") working in conjunction with the California Department of Health Services had
13 jurisdiction in determining if contaminated water had been sold to the plaintiffs. In March 1998, the
14 California PUC began an Order Instituting Investigation ("Investigation") to determine if
15 contaminated water had actually been sold by the named regulated utility defendants, including
16 Southern California. The Investigation ordered all regulated water utilities that serve more than two
17 thousand customers to file compliance reports comprised of water quality information (including test
18 results and any follow-up procedures performed) over an earlier twenty-five year period. The
19 California PUC investigated whether current water quality regulation adequately protects the public
20 health and if the respondent regulated water providers are, and were, for the prior twenty-five years,
21 complying with existing water quality regulation.

22 On February 1, 2000, a Draft Decision, which Staff stated is similar to a Proposed Opinion
23 and Order, on the Investigation concluded "that there is no dispute that existing water quality
24 regulation by the Department of Health Services adequately protects public health." The Draft
25 Decision also concluded that after reviewing compliance reports and the comments and replies of all
26 parties, the record of regulated water utility compliance with federal and state water quality
27 regulation requires no further inquiry or evidentiary hearings. No final decision on the California
28 PUC Investigation has been rendered as of July 2000.

1 Based on the information contained in the Draft Decision, Staff is confident that American
2 States' subsidiary complied with federal and state water quality regulations. At this point in time,
3 Staff stated it has no reason to believe that an American States' subsidiary in Arizona would do
4 otherwise. Based on Staff's review of information, Staff believes that the recovery of civil damages
5 related to regulated water quality standards from regulated water utilities in California is limited.
6 However, Staff recommends that the Commission condition the proposed reorganization on
7 American States' agreement to hold Chaparral's customers harmless from any judgments associated
8 with the above referenced lawsuits.

9 Staff was initially concerned whether Chaparral would retain its CAP allocation if the
10 Commission approves the proposed reorganization. Staff reviewed Chaparral's CAP subcontract and
11 determined that it is restrictive; additionally, Staff stated that A.R.S. § 45-292 requires that any
12 exportation of water from Arizona to another state would have to be approved by the Director of
13 ADWR. However, Staff recommended that the approval of the proposed reorganization be
14 conditioned on American States' agreement to only use Chaparral's CAP allocation to benefit
15 Arizona customers. In its testimony, American States stated that Chaparral retains all of its rights and
16 obligations under its present contracts for CAP water. American States further asserts that it would
17 be impossible for American States to either assume directly or transfer these agreements to another
18 non-Arizona affiliate and that Southern California could not obtain any CAP water rights directly
19 from Chaparral because to Southern California's knowledge, there are no provisions for transporting
20 such supplies in interstate commerce.

21 Based on its overall analysis, Staff believes that American States is a fit and proper entity and
22 that the proposed reorganization is in the public interest. Staff believes that the proposed
23 reorganization will place Chaparral under the control of a competent corporate parent whose principal
24 business is the provision of water service. Staff also believes that in the long-run, the proposed
25 reorganization will also benefit the shareholders of American States, thus making Chaparral's new
26 parent a stronger, more viable financial entity that will be able to attract the funds that it needs in the
27 capital markets. Staff further believes that Chaparral's water customers will not be adversely affected
28 by the proposed reorganization and that Chaparral's customers may be better off as a result of this

1 transaction.

2 Prior to the hearing, Staff, American States, Chaparral, and MCO agreed to two conditions
3 regarding Staff's recommendations on the pending lawsuits against Southern California and
4 Chaparral's CAP allocation. The conditions read as follows: 1) American States would hold
5 Chaparral harmless from any obligation to pay any judgments arising out of the now pending lawsuits
6 filed in California alleging that Southern California has delivered contaminated water to customers;
7 and 2) American States would not use Chaparral's allocation of CAP water to benefit customers
8 outside Arizona.

9 Based on the above information and analysis, the Notice of Reorganization filed by MCO and
10 Chaparral is in the public interest and should be approved pursuant to A.A.C. R14-2-803 subject to
11 the two conditions which were agreed to by the parties as referenced in the preceding paragraph. We
12 find it necessary to add another condition to protect Chaparral from any harm arising from future
13 lawsuits as follows: American States should also hold Chaparral harmless from any obligation to pay
14 any judgments arising out of future lawsuits filed in California alleging that Southern California has
15 delivered contaminated water to customers. Therefore, we shall impose this additional condition in
16 this matter.

17 FINDINGS OF FACT

18 1. On April 18, 2000, MCO together with Chaparral filed with the Commission a Notice
19 of Reorganization and/or Request for Waiver.

20 2. The hearing took place on August 10, 2000 as scheduled and public comment was
21 held on August 15, 2000. No member of the public attended the public comment session.

22 3. MCO with its wholly-owned subsidiary Chaparral, an Arizona public service
23 corporation, filed an application to divest and transfer Chaparral's issued and outstanding shares of
24 common stock to American States.

25 4. Chaparral has a CC&N to provide both potable water and irrigation service to
26 approximately 10,000 customers in Fountain Hills and Scottsdale, Arizona.

27 5. On March 10, 2000, American States entered into a contract with MCO to purchase all
28 of the common stock of MCO. After the closure of the purchase, Chaparral will be the same legal

1 entity as before, but it will now be a subsidiary of American States rather than MCO.

2 6. According to the application, Chaparral's CC&N and other property will not be
3 transferred.

4 7. American States is a holding company with two principal subsidiaries, Southern
5 California, which provides regulated utility services, and American States Utility Services Inc., which
6 provides unregulated utility related services.

7 8. MCO and Chaparral filed a Notice of Filing Affidavit of Publication on July 10, 2000
8 with notice published on June 21, 2000.

9 9. On May 22, 2000, Mr. William E. Farrell, the Town Attorney for the Town of
10 Fountain Hills, sent a letter to the Commission stating that the Town Council authorized him to
11 indicate that Fountain Hills will be supporting the acquisition by American States and would
12 respectfully request that, if all other aspects of the Commission Staff's analysis of the particular
13 docket are consistent with the Commission's policies, the Commission grant this action.

14 10. According to MCO and Chaparral, the City of Scottsdale does not oppose the
15 proposed change in stock ownership.

16 11. American States will initially finance the purchase with short-term loans of credit
17 through financial institutions with which American States has had on-going business relationships.

18 12. American States does not anticipate an increase in Chaparral's cost of service or cost
19 of capital as a result of the acquisition and that a rate increase application is not necessary at this
20 time.

21 13. American States expects to operate Chaparral for a significant period of time before
22 considering any adjustments to rates.

23 14. In its testimony, Staff stated that under the terms of the Stock Purchase Agreement
24 between American States and MCO, the cash purchase price of \$31.2 million would be reduced by
25 certain debt obligations of Chaparral. American States will pay MCO approximately \$19.5 million in
26 cash for all Chaparral's common stock shares at the time of closing.

27 15. American States has reviewed Chaparral's capital budget through 2002 and believes
28 that the existing plans are both prudent and reasonable.

1 16. Staff expressed concerns regarding the pending lawsuits against Southern California
2 and other regulated water providers that had allegedly delivered contaminated water to their
3 customers.

4 17. In March 1998, the California PUC began an Order Instituting Investigation to
5 determine if contaminated water had actually been sold by the named regulated utility defendants,
6 including Southern California.

7 18. The California PUC investigated whether current water quality regulation adequately
8 protects the public health and if the respondent regulated water providers are, and were, for the prior
9 twenty-five years, complying with existing water quality regulation.

10 19. On February 1, 2000, a Draft Decision, which Staff stated is similar to a Proposed
11 Opinion and Order, on the Investigation concluded "that there is no dispute that existing water quality
12 regulation by the Department of Health Services adequately protects public health."

13 20. The Draft Decision also concluded that after reviewing compliance reports and the
14 comments and replies of all parties, the record of regulated water utility compliance with federal and
15 state water quality regulation requires no further inquiry or evidentiary hearings.

16 21. No final decision on the California PUC Investigation has been rendered as of July
17 2000.

18 22. Based on the information contained in the Draft Decision, Staff is confident that
19 American States' subsidiary complied with federal and state water quality regulations.

20 23. At this point in time, Staff stated it has no reason to believe that an American States'
21 subsidiary in Arizona would do otherwise.

22 24. Based on Staff's review of information, Staff believes that the recovery of civil
23 damages related to regulated water quality standards from regulated water utilities in California is
24 limited.

25 25. However, Staff recommends that the Commission condition the proposed
26 reorganization on American States' agreement to hold Chaparral's customers harmless from any
27 judgments associated with the above referenced lawsuits.

28 26. Staff was initially concerned whether Chaparral would retain its CAP allocation if the

1 Commission approves the proposed reorganization.

2 27. Staff reviewed Chaparral's CAP subcontract and determined that it is restrictive;
3 additionally, Staff stated that A.R.S. § 45-292 requires that any exportation of water from Arizona to
4 another state would have to be approved by the Director of ADWR.

5 28. However, Staff recommended that the approval of the proposed reorganization should
6 be conditioned on American States' agreement to only use Chaparral's CAP allocation to benefit
7 Arizona customers.

8 29. In its testimony, American States stated that Chaparral retains all of its rights and
9 obligations under its present contracts for CAP water.

10 30. American States further asserts that it would be impossible for American States to
11 either assume directly or transfer these agreements to another non-Arizona affiliate and that Southern
12 California could not obtain any CAP water rights directly from Chaparral because to Southern
13 California's knowledge, there are no provisions for transporting such supplies in interstate commerce.

14 31. Based on its overall analysis, Staff believes that American States is a fit and proper
15 entity and that the proposed reorganization is in the public interest.

16 32. Staff further believes that the proposed reorganization will place Chaparral under the
17 control of a competent corporate parent whose principal business is the provision of water service.

18 33. Staff further believes that Chaparral's water customers will not be adversely affected
19 by the proposed reorganization and that Chaparral's customers may be better off as a result of this
20 transaction.

21 34. Prior to the hearing, Staff, American States, Chaparral, and MCO agreed to two
22 conditions regarding Staff's recommendations on the pending lawsuits against Southern California
23 and Chaparral's CAP allocation.

24 35. The conditions read as follows: 1) American States would hold Chaparral harmless
25 from any obligation to pay any judgments arising out of the now pending lawsuits filed in California
26 alleging that Southern California has delivered contaminated water to customers; and 2) American
27 States would not use Chaparral's allocation of CAP water to benefit customers outside Arizona.
28

CONCLUSIONS OF LAW

1
2 1. Chaparral is a public service corporation within the meaning of Article XV of the
3 Arizona Constitution and A.R.S. § 40-285.

4 2. The Commission has jurisdiction over MCO and Chaparral and of the subject matter
5 of the application.

6 3. Staff's, MCO's, Chaparral's, and American States' agreement to two conditions
7 regarding Staff's recommendations on the pending lawsuits against Southern California and
8 Chaparral's CAP allocation as set forth in Findings of Fact No. 35 with the modification that
9 American States shall also hold Chaparral customers harmless from any obligation to pay any
10 judgments arising out of future lawsuits filed in California alleging that Southern California has
11 delivered contaminated water to customers, is just, reasonable, in the public interest, and should be
12 adopted.

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ORDER

IT IS THEREFORE ORDERED that the Notice of Reorganization filed pursuant to A.A.C. R14-2-803 by MCO Properties, Inc. and Chaparral City Water Company is hereby approved subject to the conditions as set forth in Findings of Fact No. 35 as modified in Conclusion of Law No. 3.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN	COMMISSIONER	COMMISSIONER
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IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this ____ day of _____, 2000.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____
KEN:dap

1 SERVICE LIST FOR:

MCO PROPERTIES, INC.

2 DOCKET NO.

W-02113A-00-0233

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